



Rural Telephone Coalition

Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C. 20554

APR 12 1996

In the Matter of

Federal-State Joint Board on  
Universal Service

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CC Docket No. 96-45

Comments  
of the  
Rural Telephone Coalition

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## **SUMMARY**

The Telecommunications Act of 1996 (Act) has, for the first time, established specific goals and principles to guide the Commission, the Joint Board, and the state commissions as they develop new universal service mechanisms. The new mechanisms must preserve and advance universal service while simultaneously functioning in an open telecommunications market. Congress has committed the nation to both opening markets and ensuring the availability of quality, advanced telecommunications services available to all Americans at reasonable and affordable rates. An important addition to this new paradigm is a determination to afford special consideration to schools, libraries, and health care providers.

The specific requirements in the Act of comparability and affordability, and the identification of rural, insular, and high cost areas as targets of support, in addition to low income consumers, resolve many of the arguments raised in CC Docket 80-286 and elsewhere suggesting that universal service support should be reduced or eliminated. Thus the various proposals in that Docket's NPRM that would have caused substantial reductions in support would not meet the objectives in the Act, and, in fact, were explicitly rejected by Congress. The suggestion in the NPRM that competitive neutrality should be an additional universal service principle reflects a misunderstanding of Congress' specific recognition that, at least in areas served by rural telephone companies, special consideration must be given to the different economic situations where competition would be expected to serve only the "cream" of

the market. The specific restrictions on competition in rural areas in Sections 214(e) and 251 through 253 must be recognized in rules adopted to implement Section 254.

The new universal service support mechanism does not, per se, require elimination or extension of the Commission's Part 36 jurisdictional separations rules, because the federal support mechanism is required to meet the Act's objectives without regard to jurisdictional boundaries. States may also create support mechanisms and are required to do so to the extent they define supported service requirements that exceed the federal definition.

As a starting point, the new mechanism should maintain at least the current level of support for the defined services. The NPRM's suggestion that support be limited to residential services is inconsistent with the Act and would be damaging to those rural economies Congress is seeking to improve.

Sections 214(e) and 251-253 of the Act establish a series of opportunities for state commissions to condition competition in the areas of rural telephone companies as a result of the balancing by Congress of competition and universal service requirements in rural markets. However, the universal service support plan must accommodate those instances where the necessary public interest findings are made and a second carrier is declared eligible to receive support, as well as the areas served by non-rural companies where states are required to declare eligible any carrier that complies with the statutory requirements. The rules should specify that where such carriers use resale of the incumbent's facilities, in part, to meet their universal service obligations, they are only eligible for support for the facilities in which they actually

invest. Otherwise the fund would be paying two carriers for the same facilities. Since the incumbent carriers recover only a minority of their cost from local service rates, which are apparently then to be discounted to the reseller, the resale situation presents other complications. Thus, the Commission must, of course, ensure that the access revenues continue to flow to the underlying carrier and include any shortfall in universal service support.

The solution to the vexing issue of how to determine the amount of support for a new eligible carrier must start with the assumption that cost remains the basis for support, and that cost must be demonstrated. Otherwise, support cannot be assured to be specific, predictable, and sufficient as required by the Act, and the entrant will receive an unfair advantage at nationwide ratepayers' expense. Should the Commission, nevertheless, determine there is an immediate, compelling need to use the incumbent's cost as the measure for a new entrant's support, it should only do so for a period that allows expedited preparation of cost support by the new eligible carrier within a prescribed period, followed by a true-up.

Whenever an additional eligible carrier is designated, and especially if the incumbent's cost is used for any period, the incumbent must have the option to disaggregate its support to geographic units smaller than its study area. This disaggregation is necessary to compensate for the fact that study area wide averaging generally masks a significant range of cost of service, even for a very small company. If a new entrant received support based on the incumbent's average cost or hypothetical area wide costs, but only built in low cost, high density areas, it would receive a

substantial windfall of support and seriously damage the incumbent's ability to continue to serve.

The Rural Coalition does not support any of the methods described so far which would substitute a hypothetical cost based on a standardized architecture. Their validity has not been demonstrated and they are not readily tested. If the Commission should choose to proceed with one of these plans for its large company advocates, it must establish segregated funds, because all carriers drawing from a fund must do so under the same set of rules.

The NPRM resurrects the invalid concept that payment by IXC's for use of the local loop is only valid to the extent it is designated as explicit universal service support. Payment by an IXC to use the loop is simply compensation for value received. The correct questions are what level and what rate structure are optimal. In this context, some shift of the common line revenue requirement to the local subscriber may be desirable, but must be included in the affordability and comparability calculation prescribed by the Act.

The Rural Coalition strongly supports the Act's objectives to assist in bringing advanced telecommunications services to schools, libraries, and health care providers. These services can determine whether or not rural communities survive. A segregated fund should be instituted to ensure that the operation of this program can be carefully evaluated.

Administration of the new universal service mechanisms should be left with private entities. Introducing regulators into the administration, as opposed to oversight,

presents undesirable and unavoidable conflicts. Universal service administration should not prevent NECA from performing its duties to file and defend tariffs and administer the pools on behalf of its members. With its current experience and capabilities with both the existing USF and the TRS fund, NECA is the most natural and cost effective entity to be designated administrator.



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**Comments  
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The Rural Telephone Coalition ("RTC") files these Comments in response to the *Notice of Proposed Rulemaking and Order Establishing Joint Board* released in this docket on March 8, 1996 ("NPRM").<sup>1</sup> This proceeding is examining implementation of Section 254 of the Telecommunications Act of 1996 ("Act").

**I. GOALS AND PRINCIPLES**

**A. THE ACT ESTABLISHES EXPLICIT PRINCIPLES AND GOALS WHICH CONTROL THIS PROCEEDING**

The Act establishes for the first time since the beginning of federal regulation in 1910 explicit universal service goals and principles to which the Commission must adhere in promulgating its rules. By establishing these goals and principles and by rejecting the prior universal service approach of the Commission in CC Docket 80-286, Congress made clear that the Commission must develop a new universal service plan which protects and advances universal

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<sup>1</sup> The Rural Telephone Coalition is comprised of the National Rural Telecom Association (NRTA), the National Telephone Cooperative Association (NTCA), and the Organization for the Promotion and Advancement of Small Telecommunications Companies (OPASTCO). The RTC filed a request to exceed the 25-page limit on March 27, 1996. Since the petition was denied on April 9, 1996, these comments conform to the 25 page limit. Because the NPRM contains 62 pages of single spaced pages essentially raising issues, it is impossible to respond to all of them, even in 50 pages. Also, because the NPRM lacks specific proposals and associated rules, our discussion is necessarily limited in many places to policy comments; another round of comment on more specific rules will be needed before the public can adequately comment on the effects.

service, rather than curtails support for it.<sup>2</sup>

Section 254 of the Act specifies the policy framework for the new federal universal service support mechanisms to be funded by interstate providers, as well as any ancillary state mandated programs to be funded by intrastate providers. Congress adopted six principles that (a) commit the nation and the federal universal service support program to just, reasonable, and affordable rates; quality and advanced telecommunications and information services available to all American communities for residences and businesses; (b) empower the FCC to set an even higher standard of support for school, health care, and library telecommunications needs; and (c) broaden the responsibility for contributing to support of universal service.

**B. THE BENCHMARK FOR RURAL UNIVERSAL SERVICE IS THE URBAN MARKETPLACE**

Sections 254(b)(2), (b)(3), and (c) specify federal support mechanisms that will not only preserve but also evolve and advance nationwide universal service. The law expects that the new mechanism to be recommended by the Joint Board and adopted by the Commission will ensure that marketplace-generated urban and suburban service capabilities will be extended to rural, insular, high-cost, and low-income customers. Federal support will thus target places without the “critical-mass,” economies of scale, and other market attributes necessary for nationwide, comparably-priced but market-driven advances in services and network capabilities. In essence, the result of this approach is to mandate federal support to correct for market failure by emulating the results in competitive markets for those markets that are less attractive to multiple entrants.

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<sup>2</sup> See Section 253. The Joint Explanatory Statement of the Committee of Conference (Manager’s Explanation) says at p. 132 that a “state may adopt any measure with respect to universal service that is not inconsistent with the Commission’s rules.”

**C. “AFFORDABLE” AND “COMPARABLE” SERVICE IS NOT LIMITED TO ONLY LOW-INCOME OR RESIDENTIAL USERS**

The new statutory universal service standards add “affordable” and “comparable” rates<sup>3</sup> to the more traditional “just and reasonable.” These new policy principles must be tailored to the different universal service beneficiaries the Act intends and interpreted in the context of the specific requirements of the Act.

For comparability, the Act is to benefit all users of telecommunications in markets where free competitive forces would not yield comparable prices; *i.e.* rural, insular, and high-cost areas. To determine whether service and rates are comparable, the Commission will be required to make specific inquiries. To evaluate rates, the calling scope of small rural exchanges must be considered for such comparisons to be valid.<sup>4</sup> The level of the rates charged for comparably advanced services must all be consistent with the Universal Service principles in Section 254. The discount for schools and libraries will be set to assure access to necessary services. Health care provider rates are tied to a comparison of rural and urban rates for similar services.

The Act also identifies low income consumers as beneficiaries of federally-supported universal services.<sup>5</sup> However, the Act expressly disclaims any intention to change the existing and

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<sup>3</sup> Affordability at para. 4 and comparability at para. 14 of the NPRM .

<sup>4</sup> As shown in the CC Docket 80-286 record, the major differences in calling scope between urban and rural areas precludes direct comparison of local service rates.

<sup>5</sup>The Act at Section 254(b)(3). The NPRM asks at para. 8 whether to add low income consumers in rural, insular, or high cost areas as an explicit additional principle or public interest consideration for identifying universal service. Since low income consumers are already a beneficiary group, no such addition is necessary. Moreover, to the extent the NPRM suggests that Commission rules could or should restrict universal service support levels under the rural and urban rate and service quality principle by injecting a low income test, the notion must be rejected as inconsistent with the statute and Congressional intent. Indeed, the Manager’s Explanation makes it clear that low income subscribers were additions to the “list of consumers to  
(continued...) ”

separate Lifeline Assistance mechanism.<sup>6</sup>

Universal service now extends beyond “basic” service for all support beneficiaries. Thus, measuring universal service affordability primarily by whether subscribers drop off, continue, or establish a basic connection to the public switched network would be in conflict with the Act’s commitment to nationally available advanced telecommunications capabilities and information services.<sup>7</sup> Accordingly, while the Commission and Joint Board should pursue rules to improve and maintain subscription among low-income and minority groups, it would be incorrect to believe that the Act’s objectives are achieved solely by these means. Improving subscribership thresholds for low-income and disadvantaged consumers is very important but it is a subset of the overall task.<sup>8</sup>

**D. THE NPRM DOES NOT REFLECT THE BALANCE BETWEEN UNIVERSAL SERVICE AND COMPETITION STRUCK BY CONGRESS**

The NPRM also asks at para. 8 whether to adopt an additional universal service principle of “ensur[ing] that the means of distributing universal service support should be competitively-neutral . . .” by which the Commission means “pro-competitive.”<sup>9</sup> The extensive limitations built into the Act to protect rural areas from harmful effects of competition demonstrate that the

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<sup>5</sup>(...continued)  
whom access to telecommunications and information services should be provided.”

<sup>6</sup> Section 254(j)

<sup>7</sup> See the Act at Section 254(b)(1)-(3).

<sup>8</sup> Thus, it is clear that the suggestion in the previous CC Docket 80-286 rulemaking to address universal service solely through subscribership and low-income programs has been rejected as insufficient.

<sup>9</sup> The RTC supports the proposal to pursue the least regulatory universal service solutions. NPRM at para. 8.

proposed neutrality of distribution principle is inconsistent with the Act.<sup>10</sup> Congress has already carefully balanced the tensions between universal service, competition, and the interests of competitors in the “eligible carrier,” “rural market” interconnection-related “exemptions, suspensions, and modifications,” and universal service provisions.<sup>11</sup> Congress prescribed public interest determinations by state commissions which require specific findings before competitors can enter rural areas. These provisions are deliberate variations from the Act’s general, but not absolute, commitment to maximum competition as the chosen path to national policy and total consumer welfare. Distribution arrangements should follow the statutory universal service principles, since Congress has already determined that this approach is best for the nation’s ratepayers.

In addition, the Act delegates jurisdiction over which entities will be “eligible” to receive universal service support, in what geographic area, and the terms for relinquishing eligibility almost entirely to the authority of the individual states. Any attempt to impose non-statutory competitive neutrality provisions or to reopen the competitive and consumer protection balance Congress fully intended would fail as *ultra vires*.<sup>12</sup>

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<sup>10</sup> The “neutrality” issue appears to arise in the context of the mistaken view in CC Docket 80-286 and the FCC white paper (Preparation for Addressing Universal Service Issues: A Review of Current Interstate Support Mechanisms, February 23, 1996) that the current mechanisms are a significant reason why competitors have not sought to serve rural high cost areas. The real reason is that the potential entrants calculate correctly that they maximize the return on their investment by concentrating on lower cost, higher volume customers. The major CLECs have publicly acknowledged that their focus is on the major urban markets.

<sup>11</sup> The Act at Sections 214(e), 253(b) and (f), 251(f), and 254.

<sup>12</sup> In addition to asking whether to establish the competitive neutrality test for distribution of support, the NPRM suggests application of this test repeatedly (paras. 14, 17, 30, 40) often apparently instead of the Section 254(b) principles Congress adopted.

**E. THE REDUCTION OF SUPPORT PREVIOUSLY ENDORSED IN CC DOCKET 80-286 HAS BEEN FORECLOSED BY THE ACT**

The Act increases the scope of universal service, adds schools, libraries, and health care providers as beneficiaries and requires that support be explicit. The Act expressly requires “sufficient, specific, and predictable” federal support to meet the Act’s universal service goals. The “eligible telecommunications carrier” provision adopted by Congress requires multiple supported universal services providers in large LEC areas and allows multiple recipients in rural LEC areas. Indeed, to the extent that additional eligible carriers are designated for rural areas, more support will be required in total.<sup>13</sup> It is thus not lawful or possible to cap or limit total support, let alone reduce it. For example, if the Commission continues to demand changes in study areas be approved by it, it can no longer condition such approval on general or specific caps on universal service support.

**F. THE NEW UNIVERSAL SUPPORT MECHANISM IS REQUIRED TO ADDRESS THE TOTAL COST OF ALL TELECOMMUNICATIONS SERVICES WITHOUT RESPECT TO JURISDICTIONAL SEPARATIONS**

The Act already resolves some concerns raised by the NPRM about determining the proper division of state and federal support mechanisms. Whether Part 36 jurisdictional cost separations can no longer accomplish federal universal service support unless competing carriers

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<sup>13</sup> In thin, high-cost, low-volume markets, allowing new providers only increases the cost of support to achieve the same universal service result. J. Panzar and S. Wildman, Competition in the Local Exchange: Appropriate Policies to Maintain Universal Service in Rural Areas (1993). Furthermore, no matter how efficiently the marketplace develops multiple providers will not be able to avoid some duplicative facilities for which society will have to shoulder the cost.

all use the separations rules is not the relevant issue.<sup>14</sup> The application of Part 36 jurisdictional separations is superfluous to the universal service support mechanism.

To other LECs who may qualify for support, Part 36 has no relevance unless and until the Commission applies it to them. Even under the current rules, the federal universal service provisions are applied on a non-jurisdictional basis and then accommodated within the separated results.<sup>15</sup> The Commission needs to ensure that any continuation of Part 36 does not thwart and is consistent with the primary objectives.<sup>16</sup>

## **II. SUPPORT FOR RURAL, INSULAR, AND HIGH COST AREAS AND LOW INCOME CONSUMERS**

### **A. THE INITIAL DEFINITION OF SUPPORTED SERVICES MUST BE SET AT LEAST TO CURRENT LEVELS**

Section 254(a)(1)-(2) initiates the nation's new, expanded universal service policy by requiring "a definition of the services that are supported by Federal universal service support mechanisms." The task requires the Joint Board and the FCC to apply both (a) the four criteria required to be considered under section 254(c), (b) the six controlling universal service principles ordained in Section 254(b) and discussed above, and any other consistent principles adopted to advance the public interest (Section 254(b)(7)).

The "evolving level of universal service" is guided by the four criteria which the NPRM correctly notes are to be considered. However, a service need not satisfy all four for inclusion in

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<sup>14</sup> NPRM at para. 30.

<sup>15</sup> USF is determined on a total company loop cost basis.

<sup>16</sup> In the long run, jurisdictional separations have no place in the transformed telecommunications industry unless all providers are subject to equal application.

the federal universal service definition. The Senate provision, adopted with some modifications in conference, demonstrated that the considerations were not intended to narrow the universal service definition.<sup>17</sup>

Congress also recognized that support for “universal services” involves supporting network facilities and capabilities. Section 254(e) restricts support for federally defined services solely to “provision, maintenance, and upgrading of the facilities and services” intended to receive support. Federal support is also required to be “sufficient” to achieve the purposes of Section 254, which are prescribed in the six principles of Section 254(b)(1)-(6). The suggestion in the NPRM that the federal support might be limited to residential services is inconsistent with these principles. Rural economies depend on access to high quality, advanced and affordable service in order to be competitive in the global economy.

Upon completion of the initial rulemaking in this docket, the Commission should return to developing ways for the list of defined services to advance. Inaction should not result in a frozen set of defined and supported services. This examination should be completed in the 24 month period and then periodically, perhaps on a 24 month cycle, revisited in earnest.

## **B. ELIGIBLE CARRIERS**

### **1. SUPPORT SHOULD ONLY GO TO CARRIERS THAT INVEST IN FACILITIES USED TO PROVIDE UNIVERSAL SERVICES**

The Act makes clear that only state commission-designated carriers are eligible to receive

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<sup>17</sup>The conference report explains that, since the Senate bill was intended to “ensure that the definition of universal service evolves over time to keep pace with modern life, the subsection requires the Commission to include, at a minimum any telecommunications service that is subscribed to by a substantial majority of residential customers.” (Emphasis added). Thus, this single criterion may compel inclusion, but does not indicate that a less widely subscribed service could not also be designated.



universal service support. State commissions have the authority to mandate fulfillment of the requirement of Section 214(e) for designation as an eligible carrier of any new entrant in a rural service area. If it is in the public interest, states may grant eligible carrier status to additional carriers in rural areas, but must grant eligible carrier status to additional carriers in all other areas. The support must only go to those carriers that actually own and maintain facilities.

Resale is envisioned by the Act as a means for new entrants to get a foothold in the marketplace, but unless the support and the wholesale pricing provisions<sup>18</sup> are carefully structured, consumers could experience both substantial rate increases and a decline in service quality. The average rural telephone company's local rates cover only 35% of the cost of operating its network; the remainder comes mainly from access revenues. Local rates are, in effect, a residual set to recover all of the cost not recovered from access and toll revenues. If a state commission terminates a rural company's exemption from the Section 251(c) requirements and the company is required to provide local service for resale at a discount from its normal local service rate, the company must still have a way to recover its costs. It is obvious that access charges cannot be diverted to a reseller since they are set to compensate the underlying carrier for the cost of its facilities.

Support under both existing and new mechanisms is just one of several revenue sources which determine the marketplace's decisions to deploy capital in the form of facilities to provide the set of supported services. The only way in which policymakers are going to fulfill the vision of the Act is if support works to mitigate capital recovery risk in those areas and for those

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<sup>18</sup>Most rural LECs are exempt, at least initially, from the wholesale pricing provisions found in Section 251(c)(4). Rural LECs may also obtain a waiver or suspension of the wholesale pricing requirements pursuant to Section 251.

customers that the Act intends to support with the program. Therefore, support must motivate carriers to invest in these facilities. Similarly, support cannot be laden with high levels of risk of receipt over the long term if carriers are to be willing to accept the responsibility of the commitment to invest. Carriers cannot be expected to invest now with the expectation of support and then find it pulled from under their feet.<sup>19</sup>

**2. THE DEFINITION OF SERVICE AREA FOR PURPOSES OF APPLYING THE ELIGIBLE CARRIER QUALIFICATION RULES, TIED TO STUDY AREAS FOR RURAL TELCOS, NEED NOT BE CHANGED TO IMPLEMENT THE ACT**

The Act generally empowers states to designate a LEC's service area for the purposes of universal service and eligible carrier designation. However, as one of several safeguards against harmful rural creamskimming, Congress created an additional hurdle to changing a rural telephone company's current service area. Section 214(e)(5) requires use of such a carrier's study area "unless and until" duly changed by the Commission and the states, following recommendations from a Joint Board. The NPRM nevertheless asks for comments about redefining rural LEC study area. The issue seems to be included just because it is mentioned in the text of the Act, although unrelated to any changes. In any event, rural telephone company study areas should be left in place to identify the rural markets, with their range of higher and lower cost segments, throughout which a new "eligible" carrier should serve.

**C. IMPLEMENTATION PROVISIONS**

**1. THE LEVEL OF SUPPORT MUST AVOID DISLOCATION FROM**

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<sup>19</sup> As new entrants put undue strain on cost recovery risk and create redundant facilities, an increasing level of support will be necessary to achieve the same universal service result. See Panzar and Wildman, Competition in the Local Exchange: Appropriate Policies to Maintain Universal Service in Rural Areas, pp. 14-27.

**THE CURRENT RESULTS, BE WORKABLE IN THE NEAR  
TERM, AND BE FLEXIBLE ENOUGH TO ACCOMMODATE  
THE CHANGING INDUSTRY**

The Commission asks how the level of support under the new mechanism should be calculated.<sup>20</sup> The calculation methods must achieve several goals. First, the results cannot be disruptively divergent, specifically with respect to provisions to address high costs, from the results achieved under the current set of measures. One necessary means of accommodating this goal is to retain evaluation of actual network costs as a necessary element in the calculation.<sup>21</sup> A large number of carriers have already incurred substantial amounts of capital cost devoted to the same universal service goals advanced by the Act. The purpose of the support mechanism would be lost if the current, actual cost levels were to be disregarded in calculating support.

Calculating actual costs for individual “eligible” carriers provides the only measure, suggested so far, that can satisfy the three-pronged statutory requirement that: (a) Federal support must be “sufficient” (Section 254(b)(f)); (b) each eligible carrier must use its federal support only for “provid[ing], maintain[ing], and upgrading” the intended services and facilities (Section 254(e)); and (c) universal service support must not cross-subsidize competitive services (Section 254(k)). Basing an additional eligible carrier’s support on an incumbent LEC’s support would obviously run afoul of these statutory mandates. Such a plan would overcompensate the newcomer whether it had (efficiently) entered because its costs were lower or because the incumbent was required to charge above-cost prices. This excess compensation would then

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<sup>20</sup> NPRM at paras. 27-39.

<sup>21</sup> If costs are not considered, then those designated eligible carriers that maintain the lowest quality of network facilities, or have historically achieved the lowest quality service levels, will be rewarded for shortchanging the public’s interest in the promotion of modern, advanced services. See NPRM at paras. 3-5.

cross-subsidize its more competitive services.

## **2. ANY COMPETITIVE SUPPORT MECHANISM MUST TAKE INTO ACCOUNT THE DYNAMICS OF RURAL AREAS**

The Act provides several safeguards against potentially damaging creamskimming in areas served by rural telephone companies.<sup>22</sup> For one thing, states may require a non-mobile competitor in a rural market to be able to serve the incumbent LEC's entire study area (Section 253(f)). In addition, to become eligible as an additional universal service support recipient in such an area, a competitor is required to provide and advertise universal service throughout the incumbent's study area, and to obtain a public interest determination from the state commission (Section 214(e)(1)-(2)). A state could not rationally make the required public interest finding to designate an additional eligible carrier if the new carrier would need more support than the incumbent already providing universal service.<sup>23</sup>

In a competitive market, rival carriers will naturally gravitate toward the most profitable customers and areas in order to garner the highest return on their investment. Only with such a return will they be motivated to build facilities. Competitive carriers will not build costly facilities in remote, low-volume areas, but will choose resale as the most economic solution.

A competitive LEC must prove that its facilities are indeed high cost in order to receive high cost support. The incumbent LEC is obligated to serve all customers with its own facilities, whether they are profitable or not, and does not have the luxury that the new competitor has to

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<sup>22</sup>Creamskimming hurts rural subscribers because diversion of the least-costly customers of a rural telephone company (e.g., one or more high volume customers or the relatively dense hub of a rural area) adds to the rate burdens and undermines infrastructure development for the remaining customers.

<sup>23</sup>The existing eligible carrier's support level should accordingly provide a ceiling for an additional eligible carrier's support.

choose the most desirable location to build its facilities. The support mechanism will distort the market unless a new LEC has to prove its costs, just as the original LEC is required to do. The cost-based, facilities-targeted, competitive support approach is administratively simple, predictable, and only provides support to proven high cost facilities providers. Additionally, this competitive support mechanism will further the Act's goal of enhancing universal service by protecting the highest cost rural ratepayers from the detrimental effects of low cost, creamskimming competitors.

However, if the Commission does not choose the lawful, simple, and competitively fair mechanism of proven facilities-based costs, and instead bases support, even for a transitional period on the incumbent's costs<sup>24</sup>, the incumbent must have the option of a disaggregated mechanism. The typical case is a small rural town surrounded by vast areas of farmland. In the town, there is a relatively dense population and a number of high volume businesses with the wire center located nearby. In contrast, the subscriber density outside the town is sparse and requires long, costly loops. If the example included a more urban town in the center of an otherwise rural area, the contrast would be even greater. New entrants will build their own facilities where the incumbent is forced to price at the average, but above local cost. The new entrant will then be able to undercut the incumbent LEC who remains responsible for the outlying areas and averages its prices accordingly.

Since the new entrant will naturally build its facilities closest to the lowest cost<sup>25</sup>

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<sup>24</sup> At the very least, a true-up of the competitor's costs should be required at a time not to exceed two years after use of the incumbent's costs.

<sup>25</sup> At the extremes, the range of cost differences among small areas is estimated to be more than 100  
(continued...)

subscribers, it would get a considerable windfall of unnecessary support if it received the same averaged support that the original LEC receives.<sup>26</sup> To remedy this anomaly and target the proper subsidy to the real level of costs in a "competitive" market, the Commission must allow the current LECs to disaggregate per-unit cost to smaller geographic units. In this way, the amount of high cost and the cost of facilities necessary for the services to be supported by the new universal service mechanisms will reflect the differential among different areas. For this purpose, the smaller geographic areas would be targeted for support that is calculated separately. These support amounts in these smaller areas would be derived from the known and existing actual cost levels already established for the larger, total study area.

Since support would be adjusted accordingly, the use of smaller geographic units for determination of support would not reward creamskimmers with windfall support for serving the most dense and high volume areas.<sup>27</sup> Additionally, such a system should also require the new entrants to justify their level of support so as not to reward carriers that cut corners of the Act's mandated "quality and advanced" services. Quality considerations are an integral part of the Act's discussion of universal service policy and should be an important component of any support

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<sup>25</sup>(...continued)

to 1. Even using study area averaged data, which greatly masks much of the extremes among smaller areas, the variation among loop costs covers a range of at least 15 to 1.

<sup>26</sup> New entrants will not then be motivated to compete beneficially, but will simply identify those areas where the current providers' constrained costing, pricing, and subsidy deviates most from the real disaggregated local answer and seek to exploit it. Experts have thoroughly explained the detriment to economic welfare and the pointlessness to competition if this were allowed to occur. See Affidavit of Alfred E. Kahn filed by NYNEX in CC Docket No. 91-141.

<sup>27</sup>This disaggregation for purposes of determining costs and thus the amount of support does not affect the size of the "service area" that a competitor must serve in order to have access to funding as an eligible carrier.

level calculation scheme.

As the Act recognizes, subscribers must be protected from the detrimental effects of creamskimming. In a totally free market, these unprofitable subscribers would never be connected to the nation's network. A cost-based, facilities-directed support mechanism will continue to support these remote subscribers and enhance universal service. Simply put, it is not in the public interest to support a new entrant that only builds facilities for the benefit of the lowest cost of the high cost subscribers. The Act requires that universal service mechanisms support quality and advanced services. An evaluation of the actual cost necessary to achieve the quality and evolution of advanced service as required by the Act, together with service quality evaluation considerations, must continue to be strong administration components of a support level calculation scheme that is to comply with the Act.

### **3. THE CURRENT RESULT ACHIEVED THROUGH THE USF AND DEM WEIGHTING MUST BE RETAINED OR EFFECTIVELY PARALLELED**

The factual record in CC Docket 80-286 demonstrates that the USF and DEM weighting mechanisms have been effective in keeping local rates reasonable and encouraging rural infrastructure development that is largely comparable to urban development, as required by the Act. Both measures are explicit and easily measured, although bulk-billing to all telecommunications carriers and other providers would increase the sustainability, fairness, and explicitness of DEM weighting.

The record has shown that the costs of hardware, software, and total deployment and upgrade costs for switches serving fewer customers of lower traffic volumes are higher.<sup>28</sup> Thus,

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<sup>28</sup>See, e.g., October 10, 1995 comments of NECA, GVNW, Southwestern Bell, CC Docket 80-286.

(continued...)

DEM weighting reflects the real differences in the economies of scale available with regard to small LECs, small switches, and small average exchange size. Eliminating or reducing either the USF or DEM weighting or combining the two mechanisms would shift costs into the intrastate jurisdiction, requiring higher local rates in rural areas, and would dampen the incentives for a rural infrastructure comparable in capabilities and rates with urban areas.

The 1996 Act codifies a national commitment to rural and urban comparability of rates and services and recognition of universal service as an evolving concept, which anticipates growth of the fund. Building on the successful USF and DEM weighting programs is the best, most efficient and most reliable means of implementing the requirements and intent of the 1996 Act.

**4. THE PROXY METHODS PROPOSED TO DATE HAVE BEEN SHOWN TO BE UNACCEPTABLY INACCURATE AND ARE NOT SUFFICIENTLY DEVELOPED TO FORM THE BASIS FOR THE DISTRIBUTION OF UNIVERSAL SERVICE SUPPORT**

The inadequacy of mathematical proxy models to predict accurately an appropriate amount of cost has not changed since the Commission received comments in CC Docket 80-286 late in 1995. While Pacific Telesis has apparently proposed a somewhat different approach than that of the Joint Sponsors, the details are not yet available to the public, and thus cannot be tested. Moreover all proposed proxy methodologies require an extensive amount of additional analysis and fine tuning prior to any adoption for their use by anyone, and particularly by rural telephone companies.<sup>29</sup>

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<sup>28</sup>(...continued)

<sup>29</sup>In order to avoid burdening the record, we incorporate all the comments regarding shortcomings, additional analysis, and lack of accuracy from CC Docket 80-286.



The 1996 Law codifies that the universal service mechanism must support all services, must yield reasonable, affordable, and comparable rates, and must promote the evolution of advanced information services. A proxy method that would limit support to some preconceived cost level based on a formula that deviates from what is needed, as do both the BCM and Pacific models, is unlawful.

#### **5. COMPETITIVE BIDDING IS INCONSISTENT WITH THE ACT**

The NPRM resurrects from CC Docket 80-286 the competitive bidding proposal (para. 35), despite its conflicts with the new Act. The authority to designate eligible carriers is given to the state commissions, which in turn must be guided by the principles and goals set forth in Section 254. The Commission does not have the authority to compel states to proceed by competitive bidding. Even if the FCC had such authority, its proposed bidding process would not produce the quality of service contemplated by the Act, since the winning bidder could be the carrier which intends to commit the least resources to the area. The superficial attractiveness of forcing carriers to find ways to provide service in a more cost effective manner is not practical in the real world, at least absent a regulatory review of construction plans on an initial and continuing basis. In addition, the competitive bidding proposal is unnecessary since the 1996 Act clearly contemplates multiple eligible carriers for non-rural areas.

#### **6. NON-TRAFFIC SENSITIVE COST RECOVERY SHOULD NOT BE TRANSFERRED ENTIRELY TO LOCAL SUBSCRIBERS, AND LONG DISTANCE CARRIERS SHOULD CONTINUE TO BEAR SOME COSTS OF THE FACILITIES NECESSARY TO COMPLETE ALL CALLS**

The NPRM expresses the incorrect view that recovery of loop costs from interexchange carriers is necessarily a form of universal service support. The Commission tried to establish this